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In the Supreme Court of the United States

PACIFIC BELL TELEPHONE COMPANY
DBA AT&T CALIFORNIA, ET AL., PETITIONERS

v.

LINKLINE COMMUNICATIONS, INC., ET AL.,
RESPONDENTS

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR ABBOTT LABORATORIES AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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QUESTION PRESENTED

Whether a plaintiff states a claim under Section 2 of the Sherman Act, 15 U.S.C. § 2, by alleging that the defendant—a vertically integrated retail competitor with an alleged monopoly at the wholesale level—engaged in a "price squeeze" by leaving insufficient margin between wholesale and retail prices to allow the plaintiff to compete, when the defendant has no antitrust duty to provide the wholesale input to the plaintiff.

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INTRODUCTION AND INTEREST OF *AMICUS CURIAE*

Under the Ninth Circuit's decision in this case, any vertically integrated company that has a lawful monopoly at the wholesale level is potentially subject to "price squeeze" liability regardless of whether the plaintiff alleges—or can prove—that the company has engaged in predatory pricing at the retail level. As this Court has recognized, however, firms have every right to charge high prices for products on which they hold a lawful monopoly; that right is what creates the incentive for a great deal of beneficial innovation. Moreover, this Court's precedents establish that "low" prices do not violate the antitrust laws unless they are set below a firm's costs with a realistic prospect that the firm will later be able to recoup its losses.[1]

In short, absent a claim of below-cost pricing that meets the stringent standards of *Brooke Group Ltd.* v. *Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993), the combination of a legitimate monopolist's high wholesale prices and its low but above-cost retail prices simply does not add up to a viable antitrust claim under Section 2 of the Sherman Act.

In so holding, moreover, it is important that the Court make clear that liability for unilateral pricing decisions should be limited to situations in which a firm sets prices below its incremental costs (meas-

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[1] No counsel for a party authored this brief in whole or in part, and no person or entity other than the *amicus* or its counsel made a monetary contribution to the preparation or submission of the brief. Pursuant to Rule 37.3(a), petitioners filed with the Court a blanket consent for all *amici,* and respondents separately consented to the filing of this brief. Confirmation of respondents' consent is on file with the Clerk.

ured by average variable costs) and there is a dangerous probability that it will recoup its losses after competitors are driven from the market. Any other rule would put courts in the position of a price-control board and would discourage companies from innovating and competing fairly on the basis of low prices—all to the detriment of consumers.

Amicus Abbott Laboratories, a global health care company devoted to discovering new medicines and life-saving technologies, has a vital interest in the resolution of the issue presented here. Many of Abbott's products, which span the continuum of health care from nutritional products and laboratory diagnostics to medical devices and pharmaceutical therapies, are covered by one or more patents that confer upon Abbott a lawful monopoly over the patented product. Moreover, because it operates in every United States jurisdiction, Abbott has a strong interest in ensuring that the antitrust laws are applied uniformly, and that its pricing decisions are not subject to varying standards in different jurisdictions.

STATEMENT

This antitrust action involves the right of a company to unilaterally set its prices in the absence of an antitrust duty to deal with its customers. Respondents (collectively "linkLine") are Internet Service Providers (ISPs) that lease access for Digital Subscriber Lines (DSL) from petitioners Pacific Bell Telephone Company, et al. (collectively "AT&T"). linkLine alleges that AT&T charged too "high" a price for that access relative to the price that it charged for retail DSL Internet-access services, thereby creating a "price squeeze" in violation of § 2 of the Sherman Act.

AT&T argued below that this Court's decision in *Verizon Communications, Inc.* v. *Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004), disposed of linkLine's claim because AT&T had no antitrust duty to deal with linkLine, much less a duty to offer it a favorable price for access. A divided panel of the Ninth Circuit disagreed, holding that while the prices charged by AT&T to ISPs at the wholesale level were regulated by federal telecommunications laws, "linkLine could prove facts * * * that involve only unregulated behavior at the retail level." *linkLine Communs., Inc.* v. *Pacific Bell Tel. Co.*, 503 F.3d 876, 885 (9th Cir. 2007). Because of the possibility that AT&T's price for its retail services was sufficiently low to cause a "price squeeze," the panel's majority reasoned that the claim could survive a motion for judgment on the pleadings. *Ibid.*

Judge Gould dissented, explaining that "*Trinko* insulates from antitrust review the setting of the upstream price." *Id.* at 886-887 (Gould, J. dissenting). In other words, because *Trinko* permitted AT&T to refuse to deal with linkLine altogether, *a fortiori* AT&T was free to charge a monopoly price in the upstream market for wholesale DSL access. *Ibid.* As a result, all that remained of the claim was the challenge to AT&T's unilateral pricing decision at the retail end. *Id.* at 885-886. And since linkLine failed to allege that AT&T's prices "were below cost, under any measure of cost"—an essential element of a predatory pricing claim under *Brooke Group*—Judge Gould explained that "the case doesn't get out of the antitrust law starting blocks." *Id.* at 885-886.

SUMMARY OF ARGUMENT

Under this Court's precedents, as well as economic common sense, Judge Gould was right.

I. The antitrust laws do not restrict the ability of a vertically integrated company with a monopoly in the upstream market to set "high" monopolistic prices at the wholesale level. Under the allegations here, petitioners have lawful monopoly power as regulated participants in the upstream market for DSL transport (high-speed digital subscriber line service). And this Court's decision in *Trinko*—which confirms that AT&T had no antitrust duty to deal with respondents at all—logically means that the antitrust laws do not preclude AT&T from setting wholesale prices at a level that effectively accomplishes the same result.

In many industries, moreover, the ability to set monopolistic prices provides an essential incentive for needed innovation—which is critical to the health of any market economy and, hence, to consumer welfare. If affirmed, the Ninth Circuit's rule would directly undermine that incentive.

Given the right of vertically integrated firms to set "high" wholesale prices for products on which they hold a lawful monopoly, the antitrust laws impose no liability for a "price squeeze" absent a showing of anticompetitive pricing in the downstream, retail market. Under a long line of this Court's decisions, that means the defendant must have set its prices at a level below its costs and must have been likely to recoup its losses after driving its competitors from the market. But respondents here have failed to allege even below-cost pricing, let alone a substantial probability of recoupment.

Moreover, if the Court were to craft an exception to its below-cost rule for "price squeeze" cases, consumers would suffer. In an effort to avoid the risk of antitrust liability for aggressive but above-cost pricing, efficient firms would err on the side of higher prices, thereby harming consumers directly. And inefficient firms—including firms that ought to exit the market—would be protected by the conservative pricing decisions of their more efficient rivals. The Ninth Circuit's rule is thus fundamentally inconsistent with the purpose of antitrust law, which is to foster competition, not to force more efficient firms to set prices at an artificially high level, thus keeping their less efficient competitors afloat and, in the process, hurting consumers.

II. Under sound economic theory and this Court's precedent, unilateral pricing should not be considered "predatory" absent a showing that it is below the incremental (or average variable) cost of producing the product at issue. The only unilateral pricing strategy that can harm consumers in the long run is one that makes it impossible for equally efficient rivals to cover their variable costs. As economists across the spectrum have recognized, that level is average variable costs, not total costs, because firms generally do not exit a market if they are at least breaking even on each new sale.

Moreover, a uniform rule—no pricing below average variable costs during the allegedly predatory period—would not only give firms the certainty they need to make pricing decisions that benefit consumers, but it would also save courts from having to second-guess those decisions.

ARGUMENT

I. Vertically integrated firms with lawful monopoly power in the upstream market should not be held liable for unilateral pricing activity unless they engaged in below-cost pricing at the retail level.

As the dissent below recognized, this case is nothing more than an improperly pled predatory pricing case. 503 F.3d at 885 (Gould, J., dissenting). Although respondents allege that petitioners engaged in a "price squeeze" by setting "high" wholesale prices and "low" retail prices, they have failed to state a claim on either end. As demonstrated below in Part I.A., this Court's precedents, including most recently *Trinko*, establish that the antitrust laws permit any vertically integrated company with lawful monopoly power in the upstream market to set *wholesale* prices as it chooses—subject only to the law of supply and demand. And once the legality of petitioners' wholesale pricing activity is established, respondents cannot hope to make out a predatory pricing claim on the *retail* end. As shown in Part I.B., under several of this Court's precedents, firms cannot be held liable for unilateral pricing activity unless they priced their goods below an appropriate measure of their costs and there was a substantial probability that they would recoup their losses—neither of which has been alleged in this litigation.

A. The antitrust laws permit lawful monopolists to charge monopoly prices.

We begin with a fundamental but often overlooked principle: Plaintiffs alleging a violation of Section 2 of the Sherman Act must establish not only that the defendant possesses monopoly power, but also "the

willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident." *United States* v. *Grinnell Corp.*, 384 U.S. 563, 570-571 (1966). Legitimate monopolists, in other words, may reap the fruits of their monopolies without violating the antitrust laws, so long as they do not stray into "anticompetitive *conduct*." *Trinko*, 540 U.S. at 407.

On the wholesale side of the ledger, the only "anticompetitive" conduct that respondents allege is "high" prices. But the idea that *courts* should determine when a price becomes "unreasonable" has long been foreclosed by this Court's decisions. *United States* v. *Trenton Potteries Co.*, 273 U.S. 392, 397-398 (1927).

Moreover, it is well settled that the ability to set high prices is a legitimate fruit of a legal monopoly. As this Court explained in *Trinko,* the "charging of monopoly prices[] is not only not unlawful; it is an important element of the free-market system." 540 U.S. at 407. As a matter of basic economic theory, "[t]he opportunity to charge monopoly prices—at least for a short period—is what attracts 'business acumen' in the first place; it induces risk taking that produces innovation and economic growth." *Ibid.*

Accordingly, in order "[t]o safeguard the incentive to innovate," courts should not interfere with the reaping of monopoly profits "unless it is accompanied by an element of anticompetitive conduct." *Ibid.*; see also *id.* at 407-408 ("Compelling [monopolies] to share the source of their advantage * * * may lessen the incentive for the monopolist, the rival, or both to invest in * * * economically beneficial facilities."). And as the D.C. Circuit has observed, setting "an excessive

price alone does not establish a violation of the antitrust laws, because imposition of a high price is not, in and of itself, an anticompetitive act." *Williamsburg Wax Museum, Inc.* v. *Historic Figures, Inc.*, 810 F.2d 243, 252 (D.C. Cir. 1987).

This case involves the alleged abuse of monopoly power in the arena of telecommunications, a regulated industry. But the law allows (and sometimes encourages) monopolies in other contexts as well, whether because of natural economies of scale or because the government views monopoly status as an effective means of encouraging innovation.

Indeed, the Constitution itself sanctions granting monopolies for that purpose: To "promote the Progress of Science and useful Arts," patents give "Inventors the exclusive Right to their respective * * * Discoveries." U.S. CONST. art. I § 8. Only when patent holders use their patents to engage in anticompetitive activity do they become subject to the antitrust laws, *United States* v. *Singer Mfg. Co.*, 374 U.S. 174, 197 (1963), and the charging of monopoly prices does not amount to anticompetitive activity. Naturally, the market itself imposes limits on a patent holder's ability to dictate the price of its product; the fact that there is no perfect substitute for a patented product does not mean that demand for that product is entirely inelastic—*i.e.*, that a firm may ignore the effect of its price on sales. Richard A. Posner, *Antitrust Law* 64 (2d ed. 2001). That said, "[a] patent empowers the owner to exact royalties as high as he can negotiate with the leverage of that monopoly." *Brulotte* v. *Thys Co.*, 379 U.S. 29, 33 (1964).

This Court's precedents thus confirm that whether a vertically integrated company has lawful monopoly

power in the upstream market by virtue of "growth or development as a consequence of a superior product, business acumen, or historic accident," *Trinko*, 540 U.S. at 407 (citation omitted), the antitrust laws do not restrict its ability to charge monopoly prices at the wholesale level. Moreover, just as those laws permit a legitimate monopolist to altogether refuse to deal with its competitors, such a monopolist may lawfully accomplish the same result by setting prices at a level that its competitors find unreasonable. *Trinko*, 540 U.S. at 409; see also *Covad Communs. Co.* v. *Bell Atl. Corp.*, 398 F.3d 666, 673 (D.C. Cir. 2005).

B. This Court has consistently foreclosed liability under the antitrust laws for above-cost pricing.

Because respondents failed to state a claim at the wholesale level under *Trinko*, their claim boils down to a challenge to petitioners' unilateral pricing activity at the retail level. One searches the complaint in vain, however, for an allegation of below-cost pricing. The Ninth Circuit's decision should therefore be recognized for what it is—the imposition of a rule that forces vertically integrated firms to set retail prices based on concern, not for consumers, but for rivals.

Any such rule would be highly suspect, inasmuch as "[l]ow prices benefit consumers regardless of how those prices are set, and so long as they are above predatory levels, they do not threaten competition." *Atlantic Richfield Co.* v. *USA Petroleum Co.*, 495 U.S. 328, 340 (1990). Indeed, each time this Court has addressed the standards for allegedly anticompetitive pricing, it has held that plaintiffs must allege and prove below-cost pricing. See, *e.g.*, *Matsushita Elec. Indus. Co.* v. *Zenith Radio Corp.*, 475 U.S. 574 (1986);

Cargill, Inc. v. *Monfort of Colo., Inc.*, 479 U.S. 104 (1986); *Atlantic Richfield Co.* v. *USA Petroleum Co.*, 495 U.S. 328 (1990); *Brooke Group Ltd.* v. *Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993); *Weyerhaeuser Co.* v. *Ross-Simmons Hardwood Lumber Co.*, 127 S. Ct. 1069 (2007). As noted in *Atlantic Richfield Co.*, moreover, the Court "ha[s] adhered to this [below-cost] principle *regardless of the type of antitrust claim involved.*" 495 U.S. at 340 (emphasis added).

1. The Court has consistently declined to recognize an exception to the rule that unilateral pricing activity is lawful unless set at below-cost rates.

A few examples illustrate the Court's consistent rejection of any exceptions to this below-cost rule. In *Matsushita*, American electronics companies alleged that their Japanese counterparts, in an effort to drive their American competitors out of business, conspired to sell electronics at predatory prices. 475 U.S. at 584. Once they succeeded, the American companies alleged, the Japanese companies would restrict output and raise prices to a supracompetitive level, thereby recouping "the losses they incurred through years of pricing below market level." *Ibid.*

Holding that the plaintiffs' theory of liability was legally insufficient to withstand summary judgment, this Court confirmed that predatory pricing "means pricing *below* some appropriate measure of cost." *Id.* at 585 n.8 (emphasis added). Selling above these levels, moreover, "would either leave [competitors] in the same position as would market forces or would actually benefit [them] by raising market prices." *Ibid.*

Accordingly, above-cost pricing could not possibly be predatory.

Cargill is to the same effect. There the plaintiff sought to enjoin rival meat-packing firms from merging and thereafter engaging in a "price-cost squeeze" whereby they would bid up the price of cattle while reducing the price of beef sold to consumers. 479 U.S. at 107-108. At the retail level, however, the plaintiff alleged only that the merged company would lower its prices to a level "at or slightly above its costs." *Id.* at 114. As a result, this Court rejected the plaintiff's claim, stating: "To hold that the antitrust laws protect competitors from the loss of profits due to such price competition would, in effect, render illegal any decision by a firm to cut prices in order to increase market share." *Id.* at 116. Antitrust liability for predatory pricing requires a showing of "pricing below an appropriate measure of cost for the purpose of eliminating competitors in the short run and reducing competition in the long run." *Id.* at 117 & n.12.

Similarly, *Brooke Group* involved allegations that the defendant sold generic cigarettes at a predatory price in an effort to drive its rivals from the market, in alleged violation of the Robinson-Patman Act. 509 U.S. at 212. This Court ruled for the defendants as a matter of law, holding that plaintiffs had failed to "prove that the prices complained of are below an appropriate measure of its rival's costs" and to prove "a reasonable prospect [under Robinson-Patman], or, under § 2 of the Sherman Act, a dangerous probability, of [the defendant] recouping its investment in below-cost prices." *Id.* at 222, 224. As the Court noted, "the reasoning in both [the *Matsushita* and *Cargill*] opinions suggests that only below-cost prices should suffice, and we have rejected elsewhere the notion

that above-cost prices that are below general market levels or the costs of a firm's competitors inflict injury to competition cognizable under the antitrust laws." *Id.* at 223.

The Court acknowledged that the requirements it set forth "are not easy to establish," but that did not deter it from holding that they "are essential components of real market injury." *Id.* at 226. That is because "[t]he mechanism by which a firm engages in predatory pricing—lowering prices—is the same mechanism by which a firm stimulates competition." *Ibid.* Thus, "the costs of an erroneous finding of liability are high," and include "chill[ing] the very conduct the antitrust laws are designed to protect." *Ibid* (internal quotations omitted).

The Court in *Brooke Group* acknowledged, moreover, that "[a]s a general rule," low but above-cost pricing "either reflects the lower cost structure of the alleged predator, and so represents competition on the merits, or is beyond the practical ability of a judicial tribunal to control without courting intolerable risks of chilling legitimate price cutting." *Id.* at 223. Thus, as the Court recognized, both sound economic theory and the courts' institutional limitations warrant interpreting the antitrust laws to restrict unilateral pricing activity *only* if it is below a firm's costs.

Just two Terms ago, the Court unanimously reaffirmed and extended the holding of *Brooke Group* in forceful terms. In *Weyerhaeuser*, the Court held that the *Brooke Group* test applied not only to predatory pricing, but also to predatory bidding, in which firms bid up the prices of inputs in an effort to drive rivals from the market. 127 S. Ct. at 1072, 1075. As the Court explained, satisfying the two prongs of the

Brooke Group test are "prerequisites to recovery." *Id.* at 1074. Thus, "only higher bidding that leads to below-cost pricing in the relevant output market will suffice as a basis for liability for predatory bidding." *Id.* at 1078. The Court left no room for any claim of predatory bidding absent a showing that the defendant sold goods at below-cost prices.

As the foregoing body of precedent confirms, this Court has been unwavering in its insistence that unilateral pricing activity cannot be predatory unless the defendant firm reduces its prices below its costs. The Court has not recognized any exception to this rule, despite having addressed the question under several statutes and in varied factual contexts. Rather, this Court "ha[s] adhered to this [below-cost] principle regardless of the type of antitrust claim involved." *Atlantic Richfield Co.*, 495 U.S. at 340. Respondents' failure to allege below-cost pricing is therefore fatal to their "price squeeze" claim.[2]

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[2] Notwithstanding the substantial precedent discussed in the text, certain lower courts have interpreted the below-cost rule as limited in scope. *E.g.*, *LePage's, Inc.* v. *3M*, 324 F.3d 141, 151 (3d Cir. 2003) (en banc) (declining to apply *Brooke Group* to a bundled discount claim); *Meijer, Inc.* v. *Abbott Labs.*, 544 F. Supp. 2d 995, 1003 (N.D. Cal. 2008) (holding that an above-cost unilateral pricing decision in the pharmaceutical industry "is a strong candidate for the exception" to the below-cost rule). See also Antitrust Modernization Comm'n, Report and Recommendations 10, 94 (2007) (criticizing *LePage's* on the ground that it "offers no clear standards by which firms can assess whether their bundled rebates are likely to pass antitrust muster").

2. The Court's refusal to extend antitrust liability to above-cost pricing is consistent with the fundamental purpose of the antitrust laws—protecting consumers.

As the foregoing authorities indicate, antitrust liability for above-cost pricing conflicts with the major goal of antitrust law—fostering competition that benefits consumers. See Herbert Hovenkamp, *Federal Antitrust Policy* § 1.1 (1994) ("An important goal of antitrust law—arguably its only goal—is to ensure that markets are competitive."); Robert H. Bork, *The Antitrust Paradox* 51 (2d ed. 1993) ("The only legitimate goal of American antitrust law is the maximization of consumer welfare."). Indeed, as this Court has repeatedly recognized, "cutting prices in order to increase business often is the very essence of competition." *Matsushita*, 475 U.S. at 594. "It would be ironic indeed if the standards for predatory pricing liability were so low that antitrust suits themselves became a tool for keeping prices high." *Brooke Group*, 509 U.S. at 226-227. Without a clear safe harbor for above-cost price cutting, firms will be reluctant to make unilateral pricing decisions that pass on lower costs to customers. They will instead be compelled to err on the side of higher prices. *Ibid.*

Any exception to the below-cost rule would harm consumers in at least two ways. First, they would pay higher prices for goods in the short term because the exception would likely make firms fearful of antitrust liability if they engaged in aggressive but above-cost pricing. Such a result would be in direct tension with this Court's oft-repeated observation that "[l]ow prices benefit consumers regardless of how those prices are set, and so long as they are above preda-

tory levels, they do not threaten competition." *Atlantic Richfield Co.*, 495 U.S. at 340.

Second, less efficient firms would be protected by conservative pricing decisions from their more efficient rivals. As a result, those firms would have less incentive to become more efficient and to pass on those savings to consumers. Herbert Hovenkamp, *supra*, § 8.1. And that would tend to keep prices inflated in the long term. *Ibid.*

These harms, moreover, could well occur even in markets where an antitrust claim is unlikely to succeed for other reasons. For example, even if a below-cost predatory pricing scheme could not possibly work in a given market because of the relative ease of entry (or reentry)—providing a solid defense to potential antitrust defendants—firms may still be deterred from aggressive above-cost price-cutting because of the legal uncertainty created by an exception to the above-cost pricing safe harbor. See Einer Elhauge, *Why Above-Cost Price Cuts To Drive Out Entrants Are Not Predatory*, 112 Yale L.J. 681, 686-687 (2003).

Such legal uncertainty is no trivial matter given the ubiquity of discounts for "bundled" products in today's economy. Bundled discounts are used, for example, by airlines selling multi-stop flights and a host of other companies offering "one-stop" shopping rather than isolated components. *Id.* at 735.

Firms making any of these unilateral but consumer-friendly pricing decisions need certainty, lest they risk running afoul of a lower court that purports to find an exception to the below-cost rule set forth in *Brooke Group*. Moreover, should *this* Court create such an exception, many weaker firms would simply launch antitrust suits rather than try to match the

aggressive prices of their rivals. Although actual predatory pricing is rare, "competitors allege predation frequently." Phillip Areeda & Herbert Hovenkamp, 3 *Antitrust Law* § 723a (2d. ed. 2002). Moreover, "[u]nhappy rivals may automatically assume predation when a competitor's price is below their own costs, disregarding the possibility that the alleged predator's cost is well below theirs and more than covered by its price." *Ibid.* As the Antitrust Modernization Commission recently explained, a "lack of clear standards" may therefore "discourage conduct that is procompetitive or competitively neutral and thus may actually harm consumer welfare." Antitrust Modernization Comm'n, Report and Recommendations 12 (2007).

Indeed, allowing antitrust liability for unilateral above-cost pricing might encourage inefficient firms to enter or remain in the market in hopes of taking advantage of the higher prices. Cf. Hovenkamp, *supra*, § 8.1 (The result of using "an overdeterrent rule * * * will be inefficient high prices. This in turn will permit less efficient firms to stay in the market."). But the purpose of antitrust law is not to coddle weaker firms, or to force more efficient firms to lend a helping hand to less efficient competitors by establishing "reasonable" prices that keep them afloat. Such perverse incentives "will mean higher costs and lower product quality for society generally." Elhauge, *supra*, 112 Yale L.J. at 688.

Predatory pricing standards should therefore err on the side of underinclusiveness, avoiding what this Court has called the "cost of false positives." *Trinko*, 540 U.S. at 414. It is true that an underinclusive rule might theoretically allow marginally predatory behavior to go unpunished. But "[i]ll-conceived or ill-

defined rules impose heavy social costs by deterring legitimate pricing and by both increasing and complicating litigation." Areeda & Hovenkamp, *supra*, § 723b. Accordingly, "the best course is to develop predation rules that are somewhat underdeterrent, with the benefit of any doubt generally given to the defendant." *Ibid.* As Judge Robert Bork has put it, any attempt to enforce strict rules against predatory pricing "would do much more harm than good." Bork, *supra*, at 154.

In sum, a clear below-cost rule for unilateral pricing liability achieves the balance of deterring truly predatory behavior while encouraging aggressive pricing that benefits consumers in a wide range of contexts. This Court should therefore reaffirm "that only below-cost prices should suffice" to support antitrust liability for unilateral pricing decisions. *Brooke Group*, 509 U.S. at 223.

II. Prices should not be considered predatory unless they fall below incremental cost, as measured by average variable costs.

The remaining question is how "cost" should be determined. Although this Court has strongly suggested that a plaintiff should not be able to recover for predatory pricing "when the pricing in question is above some measure of *incremental* cost," it has not authoritatively resolved the issue of what measure of "cost" should serve as the baseline for *Brooke Group*'s rule. See *Brooke Group*, 509 U.S. at 223 (emphasis added) (citing *Cargill*, 479 U.S. at 117-118 n.12 (quoting *Matsushita*, 475 U.S. at 585 n.9)). As a result, the lower courts now set their own, sometimes conflicting, standards, thereby deterring legitimate price-cutting behavior and creating uncertainty for firms

that market products in multiple regions.[3] We therefore urge the Court to confirm that a firm's prices are predatory only if they are set below the firm's *incremental* costs, or its close surrogate, average variable costs.[4] This approach is consistent not only with this Court's guidance, but with economic theory and the fundamental purposes of antitrust.

1. As noted above, the fundamental goal of antitrust is to foster competition for the benefit of con-

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[3] See, *e.g.*, *Northeastern Tel. Co.* v. *AT&T*, 651 F.2d 76, 88 (2d Cir.1981) (average variable cost); *Cascade Health Solutions* v. *Peacehealth*, 515 F.3d 883, 906 (9th Cir. 2008) (incremental cost); *Instructional Sys. Dev. Corp.* v. *Aetna Cas.*, 817 F.2d 639, 648 (10th Cir. 1987) (prices above average variable costs may be predatory in the presence of factors such as a price increase once a competitor leaves the market or a decrease when a competitor enters); *Spirit Airlines, Inc.* v. *Northwest Airlines, Inc.*, 431 F.3d 917, 938 (6th Cir. 2005) (adopting a burden-shifting approach under which the court finds a prima facie case of predation when costs fall below average variable costs, but the plaintiff bears the burden of proving predation when costs are above average variable costs but below average total costs); *Barry Wright Corp.* v. *ITT Grinnell Corp.*, 724 F.2d 227, 233-236 (1st Cir. 1983) (same); *Henry* v. *Chloride, Inc.*, 809 F.2d 1334, 1346 (8th Cir. 1987) (same); *McGahee* v. *Northern Propane Gas*, 858 F.2d 1487, 1496 (11th Cir. 1988) (same); see also *Brooke Group*, 509 U.S. at 223 n.1 ("Because the parties in this case agree that the relevant measure of cost is average variable cost, * * * we again decline to resolve the conflict among the lower courts over the appropriate measure of cost.").

[4] Incremental (or marginal) cost measures how much firms spend to produce each additional unit of goods or services. Phillip Areeda & Donald F. Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 Harv. L. Rev 697, 700 (1975). Because incremental cost is often difficult to measure, however, average variable cost is often used in its stead. *Id.* at 716-717. By contrast, average total cost is the total cost—both fixed and variable—of producing goods and services, divided by the total units produced. *Id.* at 700-701.

sumers. See Hovenkamp, *supra*, § 1.1; Bork, *supra*, at 51. The law does so *not* by ensuring that all firms survive regardless of their relative strengths and weaknesses. Rather, it does so by ensuring that firms do not gain or use monopoly power in a way that is detrimental to consumers. *Grinnell*, 384 U.S. at 570-71; *Cargill*, 479 U.S. at 118 ("In contrast to price cutting aimed simply at increasing market share, predatory pricing has as its aim the elimination of competition.").

That is why, insofar as unilateral price reductions are concerned, the concern of antitrust law has always been limited to the possibility that one firm might drive an equally or more efficient competitor from the market, and do so permanently. In general, price reductions are good for consumers, even if they force less efficient firms to leave the market. As Judge Posner has observed, "[a] seller may want to destroy a competitor, but if the only method used is underselling him by virtue of having lower costs there is no rational antitrust objection to the seller's conduct." Posner, *supra*, 214.

The only way a unilateral price reduction can harm *consumers* is if it forces equally or more efficient firms to exit the market permanently. But firms will not be forced to exit a market if they are breaking even on each additional or incremental unit of the product or service they sell—that is, if they are covering their variable costs. Areeda & Turner, *supra*, at 701-702. Even if they are not recouping fixed costs, which are already sunk, firms will likely not abandon the effort unless they are losing money on each new sale. Bork, *supra*, at 150. And they will only be losing money on each new sale if the price they charge is less than their variable costs.

Firms that are breaking even on each new sale are particularly unlikely to abandon the market when the period of low pricing is likely to be relatively short, as it is with predatory or aggressive pricing before the firms involved again seek more robust profits. Efficient firms can weather the storm of aggressive pricing without losing money, then return to profitability once the storm passes.

Of course, incremental or variable costs cannot ordinarily be measured directly. And that is why economists typically use *average* variable costs—a well-established accounting measure—as a proxy for variable costs. See Areeda & Turner, *supra*, at 716-718.

For all these reasons, the average variable cost test is widely accepted among economists and antitrust scholars as the most appropriate judicial test for determining the propriety of unilateral pricing reductions. A unilaterally determined price must be below that level before it can create any serious risk that an equally efficient firm will exit the market, thus harming consumers.[5]

2. Adopting this uniform standard—average variable costs—will not only give firms the certainty they need to make pricing decisions that benefit consumers, it will also remove courts from the difficult posi-

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[5] *E.g.*, Areeda & Turner, *supra*, at 702 (arguing that although short-run marginal cost is the better measure, average variable cost is a more usable surrogate); Areeda & Hovenkamp, *supra*, § 724c; Janusz A. Ordover & Robert D. Willig, *An Economic Definition of Predation*, 91 Yale L.J. 8, 17 (1981); Bork, *supra*, at 150; William J. Baumol, *Predation and the Logic of the Average Variable Cost Test*, 39 J.L. & Econ. 49, 57 n.13, 58-59 (1996) (proposing a variation called "average avoidable costs" as the cost standard); Elhauge, *supra*, 112 Yale L.J. at 707-708.

tion of second-guessing those decisions. Courts need a clear benchmark such as average variable cost to make reliable and predictable decisions. Conversely, allowing courts to retain significant flexibility in determining what pricing standards to apply (and when to apply them) serves neither the courts nor the parties well. *Northeastern Tel. Co.* v. *AT&T*, 651 F.2d 76, 88 (2d Cir. 1981) ("[W]hen the costs of a misjudgment are high and the prevalence of the conduct the law seeks to deter is low, simpler rules are preferable.").

That is true, in part, because antitrust claims involving unilateral pricing decisions are particularly difficult for courts to resolve with any confidence. See Posner, *supra,* at 214 (discussing the "difficulty of distinguishing between predatory and efficient pricing"). As Judge Bork has observed of price regulation by courts and enforcement agencies, "[t]here is a high probability of mistake, and hence of harassment, by enforcement authorities and private plaintiffs that would harm consumers by inducing noncompetitive price behavior." Bork, *supra*, at 154.

Accordingly, because antitrust law is designed to encourage competition that leads to low prices, courts should give firms significant leeway in crafting aggressive pricing strategies. "If the judge uses an overdeterrent rule the result will be inefficiently high prices." *Ibid.*

Judge Easterbrook has expressed related concerns about over-deterrent antitrust rules: "If the court errs by condemning a beneficial practice, the benefits may be lost for good. Any other firm that uses the condemned practice faces sanctions in the name of stare decisis, no matter the benefits." Frank H.

Easterbrook, *The Limits of Antitrust*, 63 Texas L. Rev. 1, 2-3 (1984). An under-deterrent rule, by contrast, will likely be corrected by the market: "If the court errs by *permitting* a deleterious practice the welfare loss decreases over time" because the resulting monopoly prices will eventually attract new entrants, thereby increasing competition and reducing prices to consumers. *Ibid.* (emphasis added).

Furthermore, actual predatory pricing is particularly difficult to accomplish, and thus is rare. Areeda & Turner, *supra*, at 699. As a result, courts that over-enforce rules against predatory pricing will almost inevitably punish innocent, pro-competitive behavior, whereas courts that under-enforce those rules have some assurance that, in the end, the market will correct their errors.

The difficulty that judges face in determining whether a firm's prices violate the antitrust laws was highlighted by then-Judge Breyer in *Town of Concord* v. *Boston Edison Co.*, 915 F.2d 17 (1st Cir. 1990):

> [H]ow is a judge or jury to determine a "fair price?" Is it the price charged by other suppliers of the primary product? None exist. Is it the price that competition "would have set" were the primary level not monopolized? How can the court determine this price without examining costs and demands, indeed without acting like a rate-setting regulatory agency, the rate-setting proceedings of which often last for several years? Further, how is the court to decide the proper size of the price "gap"? Must it be large enough for all independent competing firms to make a "living profit," no matter how inefficient they may be? If not, how does

> one identify the "inefficient" firms? And how should the court respond when costs or demands change over time, as they inevitably will?

Id. at 25. Given the difficulty of these questions, it is not surprising that then-Judge Breyer would see in the judicial administration of pricing rules "a significant risk that a court's efforts to stop such price requests will bring about the very harms—diminished efficiency, higher prices—that the antitrust laws seek to prevent." *Id.* at 19. That is "why antitrust courts normally avoid direct price administration, relying on rules and remedies (such as structural remedies, *e.g.*, prohibiting certain vertical mergers) that are easier to administer." *Id.* at 25.

This Court has itself recently recognized the difficulties of administering finely tuned pricing rules. As the Court observed in *Trinko*, "[e]ven if the problem of false positives did not exist, conduct consisting of anticompetitive violations * * * may be, as we have concluded with respect to above-cost predatory pricing schemes, beyond the practical ability of a judicial tribunal to control." 540 U.S. at 414 (internal quotations omitted). The Court there explained that when "antitrust courts * * * act as central planners, identifying the proper price, quantity, and other terms of dealing," they fulfill "a role for which they are ill suited." *Id.* at 408.

This case gives the Court an opportunity to ease these difficulties by adopting what Judge Easterbrook has called a "simple presumption"—a presumption that will "mak[e] it possible for counsel to state that some things do not create risks of liability," and thereby "reduce the costs of litigation by designating

as dispositive particular topics capable of resolution." Easterbrook, *supra*, 63 Texas L. Rev. at 14. Here, affirmation of a simple rule—that unilateral price activity does not violate the antitrust laws absent a showing of pricing below average variable cost—will foster competition and give firms the predictability they need to compete.

CONCLUSION

At bottom, this is a simple case. linkLine's "price squeeze" theory rests on the notion that the antitrust laws require the courts to police the margin between the upstream and downstream prices charged by AT&T, its competitor. It is well settled, however, that vertically integrated firms with lawful monopolies in the upstream market may set monopoly prices therein, and that a firm's retail prices will not be found unlawful absent a showing that they are below cost and likely to be recouped at a later date—something respondents failed to allege.

Affirmance of the Ninth Circuit's view of "price squeeze" liability, moreover, would both chill pro-consumer pricing and force the courts into the unfamiliar and uncomfortable role of policing prices. Accordingly, this Court should reverse the judgment of the court of appeals and, in so doing, reaffirm that, regardless of the specific claim involved—be it predatory pricing, price discrimination, bundled discounts, monopoly leveraging, "price squeezes," or other price-based behavior—firms will not be held liable for unilateral pricing decisions absent a showing that they priced their product below average variable cost. Such a decision will ensure that the antitrust laws serve their fundamental purpose, which is "the protection of *competition,* not *competitors*." *Brunswick*

Corp. v. *Pueblo Bowl-O'Mat, Inc.*, 429 U.S. 477, 488 (1977) (quoting *Brown Shoe Co.* v. *United States*, 370 U.S. 294, 320 (1962)) (emphasis added).

For the foregoing reasons, the judgment of the court of appeals should be reversed.

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